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Guidance Relating to Article XXI of the United States-Canada Income Tax Convention

Notice 99–47

PURPOSE

This notice provides guidance concerning a competent authority agreement between the United States and Canada that implements Article XXI (Exempt Organizations) of the United States-Canada Income Tax Convention (Treaty).

BACKGROUND

Article XXI of the Treaty generally provides for deduction of cross-border charitable contributions, and reciprocal recognition of exemption for religious, scientific, literary, educational, or charitable organizations. Diplomatic notes that accompany the Treaty provide that the competent authorities of each of the Contracting States shall review the procedures and requirements for an organization of the other Contracting State to establish its status as a religious, scientific, literary, educational, or charitable organization entitled to exemption under paragraph 1 of Article XXI, or as an eligible recipient of the charitable contributions referred to in paragraphs 5 and 6 of Article XXI, with a view to avoiding duplicate application by such organizations to the administering agencies of both Contracting States. The diplomatic notes also provide that if a Contracting State determines that the other Contracting State maintains procedures to determine such status and rules for qualification that are compatible with such procedures and rules of the first-mentioned Contracting State, it is contemplated that such first-mentioned Contracting State shall accept the certification of the other administering agency of the other Contracting State as to such status for the purpose of making the necessary determinations under paragraphs 1, 5 and 6 of Article XXI.

SCOPE OF TREATY RELIEF

The U.S. and Canadian Competent Authorities, pursuant to Article XXVI (Mutual Agreement Procedure) of the Treaty, have entered into a mutual agreement that implements Article XXI as contemplated by the diplomatic notes. Under the terms of the agreement, recognized religious, scientific, literary, educational, or charitable organizations that are organized under the laws of either the U.S. or Canada will automatically receive recognition of exemption without application in the other country. U.S. organizations must be recognized as exempt under section 501(c)(3) of the Code in order to qualify for this treatment. Similarly, Revenue Canada must recognize Canadian organizations as Canadian registered charities.

Moreover, recognized charitable organizations resident in one country will be eligible to receive deductible charitable contributions from residents of the other country. However, in the case of a contribution (or contributions) by a resident or citizen of the United States (other than a contribution to a college or university at which the citizen or resident or a member of his family is or was enrolled), U.S. law requires that the amount of deductions in the aggregate for a taxable year may not exceed a certain percentage of the donor's Canadian source income. Any excess contribution that is not deductible as a result of this limitation may be carried over and deducted in subsequent taxable years, subject to the same limitations.

Furthermore, the U.S. will presume, in the absence of receiving certain financial information, that all Canadian registered charities are private foundations. Accordingly, if a Canadian registered charity does not provide the U.S. with the financial information needed to determine its foundation classification, the organization will be presumed to be a private foundation under U.S. law, the donor's deductible contributions will be limited to 30 percent of the donor's Canadian source income, and the organization will not have the benefit of being listed in Publication 78, Cumulative List of Organizations. Moreover, although the Canadian registered charity will not be required to apply for exemption, a donor claiming a charitable contribution deduction will be required to show that the organization is a Canadian registered charity.

Alternatively, if a Canadian registered charity provides the U.S. with the information needed to determine its foundation classification, aside from automatic recognition of exemption, the organization will be listed in Publication 78, as a foreign organization, and will be eligible to receive contributions deductible up to 50 percent of the donor's Canadian source income, assuming it is determined not to be a private foundation. If the Canadian registered charity submits information that establishes that it is a private foundation, it will nevertheless be listed in Publication 78, but deductible contributions will be limited to 30 percent of the donor's Canadian source income.

Under the agreement, recognition of exemption by the U.S. of a Canadian registered charity will remain in effect until the U.S. determines that the organization fails to satisfy the requirements for exempt status under U.S. law. Further, Canadian organizations will be required to file the applicable Form 990, Return of Organizations Exempt From Income Tax, or Form 990-PF, Return of Private Foundation, unless they receive less than $25,000 of U.S. source income.

DISCLOSURE REQUIREMENT

Section 6114(a) of the Code requires that taxpayers taking the position that a U.S. treaty overrules a general U.S. tax principle or law must disclose such position on a return of tax or, if no return of tax is required to be filed, as the Internal Revenue Service may prescribe. Accordingly, taxpayers claiming exemption or charitable contribution deductions pursuant to this agreement must disclose this position on their income tax return for the year in which the charitable contribution deduction or claim for exemption is made. Taxpayers may use Form 8833 for this purpose, or they may attach to their return a separate statement indicating that they are claiming exemption or a charitable contribution deduction pursuant to Article XXI of the Treaty. Taxpayers may make reference to Notice 99–47 in their disclosure statement.

DRAFTING INFORMATION

The principal author of this notice is Patrick Kevin Orzel of the Office of Assistant Commissioner (International). For further information regarding this notice, contact Mr. Orzel at (202) 874-1550 (not a toll-free number).

Notice of Proposed Rulemaking and Notice of Public Hearing

Guidance under section 355(e); Recognition of Gain on Certain Distributions of Stock or Securities in Connection With an Acquisition.

REG–116733–98

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to recognition of gain on certain distributions of stock or securities of a controlled corporation in connection with an acquisition. Changes to the applicable law were made by the Taxpayer Relief Act of 1997. These proposed regulations affect corporations and are necessary to provide them with guidance needed to comply with these changes. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by January 5, 2000. Outlines of topics to be discussed at the public hearing scheduled for January 26, 2000, at 10 a.m. must be received by January 5, 2000.

ADDRESSES: Send submissions to CC:DOM:CORP:R (REG–116733–98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–116733–98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/tax_regs/regslist.html. The public hearing will be held in Room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Brendan O'Hara, (202) 622-7530; concerning submissions of comments, delivering comments, the hearing, and/or to be placed on the building access list to attend the hearing, LaNita Van Dyke, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

A. *State of the Law Before Section 355(e)*

Section 355 generally provides that, if a corporation distributes to its shareholders stock of a corporation which it controls immediately before the distribution and certain other conditions are met, neither the distributing corporation nor its shareholders recognize gain or loss. A number of the conditions for tax free treatment (for example, the continuity of interest requirement of §1.355–2(c), the "no device" requirement of section 355(a)(1)(B), the five-year active business requirement of section 355(b), and the limitation on disqualified stock under section 355(d)) operate to limit the circumstances in which the distributing or controlled corporation can undergo changes of control in conjunction with a distribution that qualifies for corporate and shareholder-level nonrecognition under section 355. Nevertheless, prior to the enactment of section 355(e), it was possible for such changes to occur, for example, in the context of tax free reorganizations, while qualifying for tax free treatment under section 355. *See, e.g., Commissioner v. Mary Archer W. Morris Trust,* 367 F.2d 794 (4th Cir. 1966).

B. *Legislative Proposals Leading to Section 355(e)*

As part of its Fiscal Year 1997 Budget, the Administration proposed a provision that would require a distributing corporation to recognize gain on the distribution of a controlled corporation's stock unless the direct and indirect shareholders of the distributing corporation, as a group, controlled at least 50 percent of the vote and value of both corporations at all times during the 4-year period beginning 2 years before the distribution. *See* Department of the Treasury, *General Explanation of the Administration's Revenue Proposals,* p. 86 (March 1996) (hereinafter referred to as the "Administration Proposal"). Under the Administration Proposal, the retained 50-percent interest must consist of "permissible stock," which includes, in addition to stock retained over the 4-year period, stock of the distributing or controlled corporation "received by the shareholder in a transaction which is unrelated to the distribution . . . ." Revenue Proposals Contained in President Clinton's Budget Plan as Released on Mar. 19, 1996, §9522, [1996] 83 Stand. Fed. Tax Rep. (CCH) No. 15A.

The Administration Proposal described an unrelated transaction as, "[a] transaction that is not pursuant to a common plan or arrangement that includes the distribution," and cited a hostile acquisition of the distributing or controlled corporation commencing after the distribution as an example of an unrelated transaction. The Administration Proposal contrasted this with a friendly acquisition, which generally would be considered related to the distribution if the acquisition was pursuant to an arrangement negotiated prior to the distribution, even if the acquisition was subject to various conditions at the time of the distribution.

On April 17, 1997, House Ways and Means Committee Chairman Archer and Senate Finance Committee Chairman Roth and Ranking Member Moynihan introduced identical bills (H.R. 1365, 105th Cong. (1997) and S. 612, 105th Cong. (1997), hereinafter referred to as the "Bills") that provided for a new section 355(e) that is similar to the enacted version. The Bills were concerned with a "plan (or series of related transactions) pursuant to which a person acquires stock representing a 50-percent or greater interest in the distributing corporation or any controlled corporation . . . ." S. 612, 105th Cong. (1997). The introductory statement to the legislation contained a